

**DISCLOSURE SOLUTIONS LIMITED**  
The Old Smithy, Radwinter Road, Ashdon, CB10 2ET  
Telephone 01799 584053

Accounting Standards Board  
Aldwych House  
71-91 Aldwych  
London  
WC2B 4HN

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Dear Sirs,

**THE FINANCIAL REPORTING OF PENSIONS**

Thank you for the opportunity to comment on the above issue, which we consider should be given a higher priority by ASB and IASB. Currently accounts are misleading with regard to pensions and this needs fixing urgently. It should not be allowed to drag on indefinitely, as tends to happen at IASB with other complex issues, like bringing operating leases on balance sheet.

We regret that existing standards for employment costs, that happen to take the form of defined benefit pensions or share options, frequently downplay economic substance, and instead give priority to the legal form of what are only *potentially* long term agreements. In the real world, the overall remuneration package is not long term; it is actually an *annual* negotiation to market rates. In so far as apparent long term agreements on pensions and share options reward the current year's service, in practice less cash remuneration is paid out to those who benefit. In reality it is rare for employers to provide remuneration packages that exceed the going rate for the job for the year, unfortunately a reader of accounts would not get that impression from current financial statements.

Current standards overstate employment costs by a variety of means. You have rightly picked up one that our staff identified decades ago, namely that future discretionary salary increases are not liabilities. Even when there are salary rises, it is not unknown for new agreements to be struck that part or all of them will not count as salary for pension purposes. Another overstatement of employment costs is by spreading grant date share option amounts into future years even though the options are so far out of the money that they are ignored in the annual wage negotiation. Hence the employees in later years of the option scheme are getting the full market rate as cash remuneration which is the right expense, yet the accounts include a bogus share option cost on top.

In our opinion, more sensible results would flow from having one accounting standard for employment costs which would focus attention on arriving at the true total cost of employee services in the year, separating out for disclosure purposes any pensions and share option costs.

We set out in Appendix 1 our answers to the specific questions on which you invited comment. Should you require any clarification of the answers please contact Stuart Hastie. Our primary interest is as users of accounts and as an accountancy firm specialising in financial reporting issues.

Yours faithfully

Disclosure Solutions Limited

## APPENDIX 1

- Q1 Should a liability to pay benefits that is recognised be based on expectations of employees' pensionable salaries when they leave service, or on current salaries (including non-discretionary increases)?
- A1 Current salaries including non-discretionary increases, for the reasons given above.
- Q2A Should financial reporting be based on the premiss that a liability is owed to an individual employee or to the workforce as a whole?
- A2A. The individual employee, as that is who provided the past service and may go on to leave, die etc without affecting whether the business is a going concern.
- Q2B What consequences do you consider your view has for the recognition and measurement of pension obligations?
- A2B Not a lot, as the remuneration of the workforce as a whole, is simply the total of the remuneration of the individual employees. Properly defined and measured, there are no fresh or increased liabilities through looking at the workforce as a whole.
- Q3 Do you agree that recognition should be based on the principle of reflecting only present obligations as liabilities?
- A3 Yes.
- Q4 Do you agree that the consolidation of pension plans should be subject to the same principles as are usually applied in determining whether consolidation is appropriate?
- A4 Yes.
- Q5 Do you agree that changes in assets and liabilities relating to pension plans should be recognised immediately, rather than deferred and recognised over a number of accounting periods or left unrecognised provided they are within certain limits (a 'corridor') approach?
- A5 Yes.
- Q6 Do you agree with the paper's views in the measurement of liabilities to pay benefits?

- A6 Mostly yes (see below).
- Q6.1 Do you agree that regulatory measures should not replace measures derived from general accounting principles?
- A6.1 Yes, provided that accounts recognise liabilities at appropriate amounts where regulatory measures create legal liabilities or influence their size.
- Q6.2 Do you agree that the discount rate should reflect the time value of money only, and therefore should be a risk-free rate?
- A6.2 Yes and IASB should use that principle throughout its publications instead of reaching different answers on different accounting topics.
- Q6.3 Do you agree that information about the riskiness of a liability (i.e. the risk that the amount of pension benefits will differ from today's expectations) is best conveyed by disclosure rather than by adjusting the amount of the reported liability?
- A6.3 Yes, but the probability distribution behind today's expectations must be reflected in a present expected value liability.
- Q6.4 Do you agree that the liability should not be reduced to reflect its credit risk?
- A6.4 Yes.
- Q6.5 Do you agree that expenses of administering the plan's accrued benefits should be reflected in the liability?
- A6.5 Yes, for closed schemes only, but not generally, as the amounts are not material enough after apportionment between existing accrued benefits and the future.
- Q7 Where employees have options to receive benefits in different ways, should the liability be reported at the highest amount or at an amount that reflects the probability of different outcomes?
- A7. Expected values to reflect economic reality, not accounts distorted by excessive prudence.
- Q8 Do you agree that assets held to pay benefits should be reported at current values?
- A8. Yes.

Q9 Do you agree that a 'net' asset or liability should be based on the difference between the amounts at which the assets and liabilities would be measured if they were measured directly?

A9. Yes.

Q10 Do you agree that different components of changes in liabilities and/or assets should be presented separately?

A10. Yes, but only if they are material, as we suffer from excessive notes to accounts.

Q11A Do you agree that the financial performance of an entity should reflect the actual return on assets, rather than the expected return?

A11A Yes

Q11B Do you agree that, the expected return should be required to be disclosed?

A11B. Not unless and until companies are required to publish profit forecasts.

Q12A Do you agree with the objectives of disclosure that are identified in this Chapter?

A12A Yes.

Q12B Are there specific disclosure requirements that should be added to or deleted from those proposed?

A12B **Addition**

An improved breakdown of the assets held, so that it automatically indicates the risk characteristics e.g. for listed equities analysis (geographical and sector and by size/index)

#### **Deletions**

Separate reconciliations of scheme assets and scheme liabilities (as only the net balance makes it to the balance sheet of the employer, the reconciliation can also be provided on a net basis).

Assumptions on increases in salaries, as they do not give rise to liabilities, they must be irrelevant.

Assumptions on general inflation, as until IASB have addressed inflation accounting generally, there is no need to inflation account for pension costs

alone.

The investment strategies that gave rise to the assets held, as they are not determined by the employer that these accounts relate to. Such disclosure belongs in the trustees' report of the pension fund instead.

The risk exposure of each financial instrument, as it should already be blindingly obvious from the description of the assets, as indicated above.

Expected rates of return.

Q13A Do you agree that multi-employer plans should be reflected in an employer's financial statements using the same principles as those that apply to a single employer plan?

A13A Yes.

Q13B How, in your view, should an accounting standard require that this be implemented in practice?

A13B By sharing any deficit or surplus amongst the various employees (pro rata to the liabilities of their employees/pensioners if there is no other contractual basis of allocation).

Q14A Do you agree that a pension plan's general purpose financial report should include its liabilities to pay benefits in the future?

A14A Yes. It is not really a balance sheet without them and the current situation puts the whole accounting profession in such a poor light that it ought to be remedied promptly by a new standard, without waiting for a standard to be revised for employment costs.

Q14B Do you agree that the plan's liabilities for future benefits should be quantified using the same principles as an employer's liability?

A14B Yes, in principle, but that is no reason to delay remedying the lack of a recognised liability.

Q15A Do you agree that a pension plan's statement of financial position should reflect an asset in respect of amounts potentially receivable under an employer's covenant?

A15A Yes.

Q15B Do you agree that this should reflect the employer's credit risk?

A15B Yes and the impairment provision should be separately disclosed along with the gross amount.

Q16A Are there types of pension arrangements that require further consideration?

A16A Probably.

Q16B Please identify the specific features of these arrangements and suggest how the principles of this paper would require development to secure appropriate financial reporting for them.

A16B Depends on other responses.

Q17 Are there further specific issues relating to the cost and benefit of the proposals that should be taken account of in their further development?

A17 No.